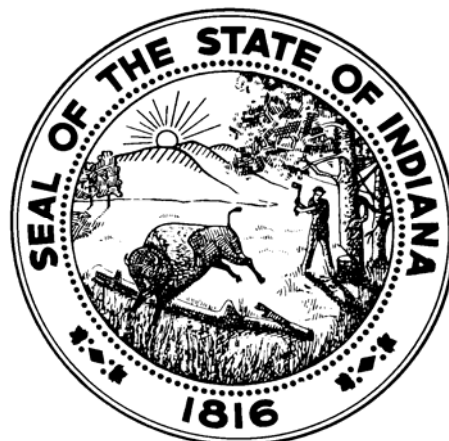


STATE BOARD OF ACCOUNTS
302 West Washington Street
Room E418
INDIANAPOLIS, INDIANA 46204-2765

AUDIT REPORT
OF

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
STATE OF INDIANA

July 1, 2005 to June 30, 2006



FILED
11/28/2006

TABLE OF CONTENTS

<u>Description</u>	<u>Page</u>
Agency Officials.....	2
Transmittal Letter	3
Audit Results and Comments:	
Employer and Employee Member Reserve Reconcilements	4-6
Modifications to SIRIS Transactions	6
Benefit and Refund System Control Weaknesses	6-8
Uncorrected Prior Errors	8-9
Underpayment of State Employee Disability Benefits	9-10
Employer Reserve Charges.....	10
Lack of Benefit Transaction Accounting	10-11
Tax Withholding Remittance Errors	11-12
Legislators' Defined Contribution Fund Not Reconciled	12
Investment Accounting and Transfers	12-13
Exit Conference	14
Official Response	15-16

AGENCY OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Executive Director	David Adams	03-08-05 to 06-30-07
Chairman of the Board	Ken Cochran	06-17-05 to 04-05-08



STATE OF INDIANA
AN EQUAL OPPORTUNITY EMPLOYER

STATE BOARD OF ACCOUNTS
302 WEST WASHINGTON STREET
ROOM E418
INDIANAPOLIS, INDIANA 46204-2765

Telephone: (317) 232-2513
Fax: (317) 232-4711
Web Site: www.in.gov/sboa

TO: THE OFFICIALS OF THE PUBLIC EMPLOYEES' RETIREMENT FUND

We have audited the financial statements of the Public Employees' Retirement Fund Board of Trustees as of and for the year ended June 30, 2006, and have issued our opinion thereon dated September 29, 2006. The financial transactions of this office are reflected in the Public Employees' Retirement Fund of Indiana's Comprehensive Annual Financial Report.

In planning and performing our audit, we considered the internal controls over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain conditions in the design or operation of one or more of the internal control components that, in our judgment, need to be addressed by management. We also noted certain issues of noncompliance with statutes and board policies that, in our opinion, should be communicated to management.

The internal control conditions and the issues of noncompliance are disclosed in the following Audit Results and Comments. In addition, information about these internal control conditions may be found in our separately issued Communication of Internal Control Related Matters Noted in Our Audit, dated September 29, 2006.

STATE BOARD OF ACCOUNTS

September 29, 2006

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2006

EMPLOYER AND EMPLOYEE MEMBER RESERVE RECONCILEMENTS

History

In our prior eight audit reports, the most recent being Report B26177, we have stated that the member and employer reserves had unidentified variances between the subsidiary computer system records and the general ledger balances. From July 2000 to March 2002, no reconciliations were performed. During this time a critical system conversion occurred. Prior to that time, and thereafter until June 2004, incomplete reconciliations were performed with resulting unidentified variances. Effective June 30, 2004, adjusting entries were recorded to the general ledger to recognize the unidentified variances, which were either significant or material to each of the funds administered.

During the fiscal year ended June 30, 2005, we had identified specific errors and concerns that remained as conditions due to the lack of a process to understand and ensure the accuracy of transactions affecting member and employer subsidiary accounts and to affirm the total balances accounted for through data extracts used for accounting. The following sections address the actions taken to correct the employer accounts and the remaining concerns pertaining to complete accounting for member account transactions.

Employer Reserve Status at June 30, 2006

During the fiscal year ended June 30, 2006, PERF reconstructed employer subsidiary ledger accounts, maintained in accordance with Indiana Code 5-10.2-2-2 and 5-10.2-2-6, for all pension funds administered by PERF. PERF restated the employer balances in order to correct errors identified in our prior report and to accurately restate earnings allocations. Our prior report identified a cumulative total of \$1.2 billion in excess retirement costs that had been recorded to PERF employer accounts by June 30, 2005. These charges were largely referenced to deceased retirees, for whom no additional actuarial costs are owed. The reconstruction of the employer accounts effectively reversed the excess costs. That report had also identified a logic error applied to all pension funds, whereby the unreserved fund balance was included in the earnings applied to employer accounts for the fiscal year ended June 30, 2004. We found that this error also occurred in May 2006, upon recording the earnings for the fiscal year ended June 30, 2005. The reconstruction of the accounts effectively reversed the earnings allocation logic errors for both years for each of the pension funds. For the PERF fund, the earnings allocations were restated, effective June 30, 2004 and 2005, by applying the earnings to the account balances after restatement to correct the excess retirement costs.

The system continued to record excessive and unnecessary actuarial pension costs throughout fiscal 2006. A process was implemented, however, to manually examine transactions and to recognize only those which were for final approved and valid transaction types. Reserve entries were also recorded at June 30, 2006, to recognize funding necessary for the retirements paid from the general ledger (non-SIRIS) system.

Due to the above noted restatements and process changes, the employer reserves were considered materially correct at June 30, 2006.

PERF plans to record the detail reconstructed for fiscal 2006, as provided for audit, to an accounting ledger record for historical purposes. During fiscal 2007, PERF plans to maintain the employer accounts within its general ledger system.

We recommended that PERF identify the cause of the system error in recording the excessive and unnecessary actuarial pension costs. This would reduce manual effort and provide an increased efficiency in recording valid transactions. We also recommended that PERF implement the plan to maintain the employer accounts within the general ledger system.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2006
(Continued)

Employee Member Reserve Status at June 30, 2006

Accounts are maintained for each member employee on the computer system SIRIS. PERF provided us with data for all transactions posted to SIRIS from inception through June 30, 2006. We abstracted totals recorded during the fiscal year ended June 30, 2006, for each of 42 member transaction types and calculated grand totals of the member balances held for each fund. We could not trace or compare the detail transaction types to the accounting and reconciliation process in place. Total PERF member transaction variances between our compilation and that of the accounting reconciliation project ranged from additions to member accounts via contributions overstated by \$5.4 million to deductions from member accounts for retirements overstated by \$6 million. As the detail system transaction types were not identified within the reconciliation process, we could not ascertain which, if any, detail transactions were omitted or inaccurately identified for reconciliation.

The grand total of the member accounts compiled in the reconciliation process was under that of both our calculations and that of system reports run at June 30 for each fund, except for the Judges' Retirement Fund. The reconciliation was under by \$3.6 million for PERF, by \$1.1 million for the 1977 fund, by \$655 thousand for the Prosecuting Attorney's fund, and by \$130 thousand for the Conservation, Gaming, and Excise Officers' fund. The Judges' member balances were overstated by \$48 thousand. Totals necessary to fully reconcile the grand totals were not considered material to any of the funds administered; however, if not adequately addressed, these differences could become material in future periods.

Improvements in the process of identifying and accounting for the detail member transactions continue to be necessary. We observed the following types of detail transactions in fiscal year 2006 which did not appear to have a full accounting -- benefit check overrides in order to pay more than the balance on an account, money moved from PERF accounts to Judges' accounts, contributions re-entered into prior effective years upon processing a disability effective in the prior period. Various adjustment transactions that increase member balances are in use within SIRIS. These have not been associated with cash transactions or an accounting review. Also, member balances have not been removed for those receiving the non-SIRIS benefit checks.

An increased understanding of the detail system transactions performed by operations staff is necessary to design the control structure for the associated communication, procedures and monitoring that may be necessary for accurate and complete accounting. As stated in our prior report, the documentation of the entire SIRIS system remains incomplete. The definition, source and timing of recognition have not been identified for either the SIRIS accounting entries or the SIRIS member account transaction types. Each type of SIRIS transaction has not been associated to the reports, screens or data bases.

The effect of the incomplete accounting for the member transactions is to require a funding transfer from another source in order to balance to the accurate total. This funding is usually provided by reducing earnings available to allocate to employer accounts.

We recommended that PERF identify the system transactions used for member transactions, obtain an understanding of the operational use, and design the control structure for the associated communication, procedures and monitoring that is necessary for an accurate and complete accounting. The reconciliation process should utilize the full population of the data transactions and calculations of grand totals in the system in order to ensure that accuracy and completeness of the accounting has occurred.

Indiana Code 5-10.2-2-2 directs that the Board of Trustees of the Public Employees' Retirement Fund shall maintain separate accounts for the retirement allowance account and the annuity savings account. Indiana Code 5-10.2-2-6 further requires that separate accounts for employer contributions from the state and each political subdivision be maintained within the retirement allowance account.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2006
(Continued)

Indiana Code 5-10.3-3-7.1 provides that:

"The board shall annually analyze for internal control purposes the fund's:

- 1) income and expenditures;
- 2) actuarial condition;
- 3) reserve accounts;
- 4) investments; and
- 5) such other data as necessary to interpret the fund's condition and the board's administration of the fund."

MODIFICATIONS TO SIRIS TRANSACTIONS

As stated in our prior Report B26177, each transaction recorded to a member or an employer account on the SIRIS system has a transaction date and an effective date. In our test of member refunds we found transactions processed in fiscal 2005 that had the original transaction dates changed to the 1980s. We found that member transactions were recorded to prior periods, including contributions and member interest added to member accounts, additional amounts removed from accounts at retirement, and adjustments to disability and retirement transactions.

One of the effects of changing or incorrectly assigning transaction dates is to omit transaction amounts from current data collections that are used to provide accounting information. As a result the process to identify the transactions for accounting information becomes complex. It requires cumulative data comparisons between current cumulative totals of transactions and a prior cumulative transaction data set.

In fiscal 2006, PERF established policy and documented procedures for change requests, including a change approval log. However, no reports were produced that could be used to monitor for unapproved changes to transactions.

We recommended that a report be produced to identify all current transactions recorded to a prior transaction date. This should be monitored to ensure that such transactions have been properly approved and accounted for.

Indiana Code 5-10.3-3-7.1 states: "The board shall annually analyze for internal control purposes the fund's; (1) income and expenditures; (2) actuarial condition; (3) reserve accounts; (4) investments; and (5) such other data as necessary to interpret the fund's condition and the board's administration of the fund."

BENEFIT AND REFUND SYSTEM CONTROL WEAKNESSES

Our prior three reports, the most recent being Report B26177, have indicated specific control weaknesses in the design and operation of the computer system (SIRIS) that is used to process benefits and refunds, and which also maintains the subsidiary accounts for the members reserve. The status of these weaknesses at June 30, 2006, is given below.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2006
(Continued)

Disbursement Controls

PERF had certain system controls disabled which would have insured that disbursements against a member's annuity account would not exceed the balance in the account. Additional monitoring was not implemented. Excess payments could be made via multiple payment requests or by system overrides. We observed the use of the benefit override function in order to pay members in excess of their account balance. In the case observed, PERF staff had noted that the excess payment was made to correct an error in interim interest. However, proper accounting cannot occur without an associated entry to the member account, which was not made.

SIRIS maintains check records for disbursement transactions that have been entered, but not yet authorized. Information concerning such check records is not regularly provided to the accounting department for review.

We recommended that system controls be utilized to ensure that disbursements against a member's annuity account cannot exceed the balance in the account. Until such time as this can reasonably be assured, we recommended that output reports be designed to communicate to management the use of benefit override functions and to report when payments issued exceed a member's account balance. Such reports should then be reviewed in a timely manner to ensure that the transaction is allowable and properly recorded. Information concerning check records in a status other than final should be reviewed by the accounting department on a regular basis.

Processing of Final Service and Contributions

The system design did not ensure that benefits and refunds were processed, calculated, and paid accurately and timely with respect to the processing of the final contributions. As a result, PERF implemented a final benefit recalculation process which will be applied during fiscal 2007 to all benefits and refunds processed since fiscal 2004. PERF should ensure that the final recalculation process is designed to identify cases of unposted contributions as may be indicated by the final dates of service.

The SIRIS design omits a transaction to record final service credit. Service credit is regularly recorded in quarter year increments upon posting quarterly contributions. In order to post the exact service credit total for a retirement, PERF staff must now access and delete contribution entries and re-enter the same contributions with the correct service credit total. An additional level of review is in place for this specific transaction to ensure the contributions are re-entered correctly. However, we continue to observe contributions which were re-entered with a different effective date, including those of prior years. As such, the contributions recorded would no longer be properly associated to the period of receipt of the funds. Reconciliations of the receipts therefore could not be accurately or fully completed.

We recommended that PERF evaluate the need to process retirements with re-entry of contributions with a different effective date. If there is no valid system requirement to do so, then staff should be instructed to discontinue this process.

Inadequate Segregation of Duties

Segregation of duties is achieved by organizing job functions to prevent an individual from concealing errors or irregularities through the normal course of their authorized duties. Segregation of duties is enforced, in part, through appropriate assignment of user security rights which are based on each user's need to access, update, and process data. Within SIRIS, sets of security rights are organized into various roles which can then be granted to user IDs, based upon each user's job functions. Currently there are 162 SIRIS roles.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2006
(Continued)

Clifton Gunderson LLP was contracted to perform a SIRIS security analysis during 2004. During this analysis they identified incompatible roles and developed a method to identify user IDs that have been assigned conflicting role assignments, which are role combinations that would fail to enforce appropriate segregation of duties. Several user IDs have more than 50 SIRIS roles, many of which are conflicting. For example, one individual has 93 roles which include at least 30 incompatible role combinations. Although an access request form has been developed and an authorization list is maintained, numerous PERF employees continue to have SIRIS access, which could allow staff to conceal errors or irregularities.

We recommended that PERF review the system role assignments. Incompatible role assignments should be identified and removed to help ensure segregation of duties.

Indiana Code 5-10.3-3-7.1 states: "The board shall annually analyze for internal control purposes the fund's: (1) income and expenditures; (2) actuarial condition; (3) reserve accounts; (4) investments; and (5) such other data as necessary to interpret the fund's condition and the board's administration of the fund."

As part of common business practices, governmental units' computerized accounting systems must provide input edits and controls to assure that information entered into the system is accurate, that all appropriate information is entered into the system, that information is entered into the system only once, and that all information entered into the system is authorized by management. Governmental units should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of managements' objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are necessary for proper internal control.

UNCORRECTED PRIOR ERRORS

As stated in our prior three audit reports, the most recent being Report B26177, under the audit results and comments entitled Benefit and Refund Errors and Unpaid Retroactive Benefit, we found various anomalies in the calculation of members' benefits and refunds. As detailed in the prior reports, these anomalies resulted in both underpayments and overpayments to members. The causes varied, but were mainly due to SIRIS programming anomalies, input errors, and incorrect data used in benefit calculations.

PERF has implemented, or is in the process of implementing, various steps to improve the accuracy of members' benefits and refunds as well as to correct errors. The following are steps being taken to correct the errors noted in the finding Benefit and Refund Errors:

First, as noted in our prior audit reports, PERF hired a CPA firm (Clifton Gunderson LLP) to recalculate all benefits and refunds that were processed from the inception of the SIRIS system in April 2002 through June 30, 2004. On June 16, 2006, a final report was issued by Clifton Gunderson denoting the number of instances where benefits were paid correctly, overpaid or underpaid. Errors noted by Clifton Gunderson and in prior audits have yet to be corrected. A contract is in effect to complete member account adjustments during fiscal year 2007.

Second, during fiscal year 2006, in an effort to ensure effective controls and processes are in place, PERF has retained Clifton Gunderson to help implement and maintain its quality assurance function over the verification of member information and calculations in the payment of benefits.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2006
(Continued)

Third, in fiscal year 2007, a process known as "Final Benefit Audit and Analysis" is to be implemented. Clifton Gunderson has been contracted to perform this process. This process is a control to help ensure the accuracy of benefit payment calculations. Presently, all member accounts processed since June 30, 2004, are being held in "estimated" status. These accounts will remain in estimated status until the "Final Benefits Audit and Analysis" process has been performed on these accounts. This process includes analyzing and validating final creditable service as attested to by the employer, as well as employer contributions and employee Annuity Savings Account contributions and interest through the date of retirement. In the future, PERF management anticipates the "estimated" status period will be approximately six to nine months as final data is obtained.

The programming error noted in the Unpaid Retroactive Benefit finding, which resulted in the underpayment of retroactive benefits, was corrected by management in a prior period. However, underpayments which resulted from the programming error have yet to be corrected. These errors are to be corrected as a part of the "Final Benefits Analysis and Audit" process.

We recommended that the quality assurance function be maintained. We also recommended that the "Final Benefits and Analysis and Audit" process be implemented and that appropriate adjustments to member accounts be made.

Indiana Code 5-10.3-3-7 states in part: "the Board of Trustees shall . . . 5) Provide for the installation in the general office of a complete system of books, accounts including reserve accounts, and records in order to give effect to all the requirements of this article and to assure the proper operation of the fund."

Indiana Code 5-10.2-2-1.5 states in part: "(1) Each board shall distribute the corpus and income of the fund to members and their beneficiaries in accordance with the retirement fund law. (2) No part of the corpus or income of a fund may be used for or diverted to any purpose other than the exclusive benefit of the members and their beneficiaries."

UNDERPAYMENT OF STATE EMPLOYEE DISABILITY BENEFITS

As stated in our prior three audit reports, the most recent being Report B26177, state employees who become disabled may begin to receive their PERF disability retirement while also receiving the state long-term disability benefit. Additional state service is earned while on the long-term disability plan. The state disability plan administrator reports to PERF when the state disability benefit term is completed, which cannot exceed a four year term. The PERF pension benefit should then be increased by recognizing the total state service credit. We further stated in our prior audit reports that, since May 2002, unless the member contacted PERF to complain, PERF had not recomputed any state employee disability retiree pensions after the completion of their coverage under the long-term disability plan.

In June 2006, PERF implemented the "Disability Recalculation Process." This process is initiated when the state disability plan administrator sends a copy of the termination notification letter sent to the individual receiving disability benefits to PERF. When notification is received, officials log the information into an Excel spreadsheet for tracking purposes. The tracking process includes documenting when benefit recalculations and adjustments have been made to member accounts, when notification has been sent to the member, and when pertinent documents have been electronically imaged to member accounts.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2006
(Continued)

Through inquiry we found that a backlog does remain of accounts from prior audit periods and the current audit period of those members who are due additional creditable service and benefits. Since June 2006, PERF has made significant progress in reducing this backlog. Officials have set a goal of eliminating 100% of the backlog of all affected accounts by October 31, 2006. Additionally, there are a small number of accounts for deceased members subject to recalculation. Due to additional documentation requirements required for deceased members, a timeframe has not been established for completing this process.

We recommended that the backlog continue to be reduced, including the required recalculation for deceased members. We also recommended that PERF obtain periodic, timely printouts of all members who are subject to termination of disability benefits from the disability plan administrator as an added check to ensure that all members subject to recalculation are captured.

Indiana Code 5-10.2-3-1(f) states: "A member who is a state employee is entitled to service credit for the time the member is receiving disability benefits under a disability plan established under IC 5-10-8-7."

Indiana Code 5-10.2-2-1.5 states in part: "(1) Each board shall distribute the corpus and income of the fund to members and their beneficiaries in accordance with the retirement fund law. (2) No part of the corpus or income of a fund may be used for or diverted to any purpose other than the exclusive benefit of the members and their beneficiaries."

EMPLOYER RESERVE CHARGES

As stated in our prior three audit reports, the most recent being Report B26177, employer reserve charges are the actuarial calculated costs to the employer for the funding of the member's pension at retirement. In our testing of employer reserve charge amounts, we found that incorrect actuary tables were used to calculate the pension funding and that the table factors were incorrectly applied.

At June 22, 2006, PERF updated and loaded reserve factors tables. Due to the late implementation, the correct application of the tables on a consistent basis will not become apparent until fiscal 2007.

We recommended that the actuary tables adopted by the Board of Trustees in accordance with Indiana Code 5-10.3-3-7(7) be accurately applied.

LACK OF BENEFIT TRANSACTION ACCOUNTING

As stated in our prior three audit reports, the most recent being Report B26177, there was no definitive population data for new benefits, benefit adjustments, or benefit deletion transactions. The expected benefit payroll was not being properly tracked or monitored. Reports that had been developed to aid in tracking and monitoring were not functioning as designed. To compensate, in fiscal 2005 officials developed a manual process for tracking these changes. However, control procedures over the monitoring of this process and ensuring the validity of transactions were not present.

For fiscal 2006, PERF developed a series of reports designed to track all new, terminated, and adjusted retirees. Additionally, a procedure for monitoring and analyzing these reports, known as "Auditing Current Check Runs," was developed. This process is designed to track and verify for each fund, on a test basis, those classified as new retirees and terminated retirees since the prior month. Also, the difference in

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2006
(Continued)

payments to members from one month to the next is to be monitored. Finally, the accuracy of total check amounts reported on the detail reports is to be verified. Utilizing the reports, this process is to be completed by the General Ledger Accountant and reviewed by the Accounting Manager, who are independent of the benefits process. These reports, in conjunction with the procedures "Auditing Current Check Runs," replace the manual process put in place during the prior period.

The process is to be completed monthly by the last day of the month following the month to be audited. Because these transactions are not reviewed prior to the issuance of benefit checks, it is important that management complete its process in a timely manner so that any necessary corrections are implemented as quickly as possible.

The process was implemented in June 2006 and back-tracked so that the months of December 2005 through April 2006 were included. However, because the testing for all the months occurred in June, we were unable to determine that this new process was being utilized in a timely manner.

We recommended that the new process be maintained with periodic review of the scope of the testing. Currently, testing is based on a sample of 20% for each type of transaction (new benefits, benefit adjustments, and benefit deletions). If it is found that exceptions are low or are static with one type of transaction but high and/or variable in another, sampling methods should be modified. We also recommended that the new process be completed within the timeframe established in the procedures.

As part of common business practice, governmental units should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations.

TAX WITHHOLDING REMITTANCE ERRORS

As stated in our three prior year audit reports, the most recent being Report B26177, errors were made in reporting the taxes withheld from benefit and refund checks. For calendar years 2004 and 2005, this resulted in tax returns based on incomplete information. The 1099 reporting for calendar years 2004 and 2005 does not agree to the withholdings reported for the PERF fund. PERF compared the 2004 and 2005 federal return information for all of the funds to its general ledger. The general ledger accounts for the federal and state withholdings do not agree to the liabilities for the year claimed by PERF on federal and state tax filings. The basis for the liabilities reported to the federal and state taxing authorities was a SIRIS report of the form 1099s issued for the fund that was printed in January of each year. However, we noted that the 1099 function of SIRIS had several types of errors and omissions identified by staff. Various revisions to 1099 information were noted as occurring through June 2006. The same condition is also likely to have occurred for the other funds administered by PERF, as their returns were filed using the same system reports and dates.

PERF plans to file amended 2004 and 2005 tax returns when filing the 2006 return. Funds may be required to repay tax withholding account refunds previously claimed. Information provided indicates that PERF owes approximately \$200,000 in federal and \$60,000 in state taxes. The 1977 Police Officers' and Firefighters' Pension and Disability Fund owes approximately \$11,000 in federal withholdings.

At June 30, 2006, the balance of the PERF withholding accounts did not agree to the identified current withholdings owed. The PERF general ledger balance of the withholdings payable has not been adjusted for the variance between the expected refunds or amounts due and the actual refunds received or payments made that were identified by PERF.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2006
(Continued)

We recommended that PERF implement effective procedures to provide timely and accurate tax liability reporting information. We further recommended that PERF continue to reconcile the balance of the withholding accounts, identify the current withholdings owed, and adjust general ledger account balances as necessary in a timely manner.

Every governmental unit is required to comply with all filing requirements of federal and state agencies. Officials and employees have the duty to pay claims, remit taxes, etc., in a timely fashion. Any penalties, interest or other charges paid by the governmental unit may be the obligation of the responsible official or employee.

LEGISLATORS' DEFINED CONTRIBUTION FUND NOT RECONCILED

As stated in our prior two audit reports, the most recent being Report B26177, beginning January 1, 2004, the PERF Board implemented a pilot program for the Legislators' Defined Contribution Fund in accordance with public law. The PERF Board contracted with a service provider in order to implement daily investment selections. This contractor maintains detail accounts for each member and performs the necessary bank transactions associated with member options. The PERF Board had not obtained or required a reconciliation of the service provider's records to the associated bank records as of June 30, 2004, and June 30, 2005.

As of June 2006, PERF required the service provider and custodian bank to identify prior years' errors and to correct their records. PERF developed written procedures in June 2006, which were modified in August 2006, in order to further ensure accuracy of the fund accounting.

At June 30, 2005, the Legislators' Defined Contribution Fund had insufficient funds available to reimburse two other pension funds that it owed. As of June 30, 2006, the \$477,208 remained a liability of the fund to these funds. PERF continues to review this matter.

We recommended PERF maintain an effective accounting and reconciliation process and adequate related supporting documentation for the Legislators' Defined Contribution Fund. We further recommended PERF document any action taken regarding the fund liability matter for future audit.

Public Law 126 - 2003 section 1(d)(1) states that "Notwithstanding IC 2-3.5-5-3(b)(2), the PERF board shall implement a member's selection under IC 2-3.5-5-3 not later than the next business day following receipt of the member's selection by the PERF board. This date is the effective date of the member's selection." Section 1(d)(2) states that "Notwithstanding IC 2-3.5-5-3(b)(7), all contributions to a members' accounting the fund must be allocated under IC 2-3.5-5-3 not later than the last day of the quarter in which the contributions are received and reconciled in accordance with the member's most recent effective direction."

INVESTMENT ACCOUNTING AND TRANSFERS

Our prior seven audit reports, the most recent being Report B26177, stated that PERF did not have procedures in place to ensure that contributions are deposited in the appropriate investment accounts and are recorded in the correct fund's unitized owner account, transfers are between authorized accounts, transactions are in compliance with Board decisions and directives, and a timely review of custodian bank reports has occurred. Evidence of such controls should also be established and results should be communicated to management on a regular basis and made available for audit. The prior report stated that certain controls were implemented whereby PERF did detect and correct errors. However, concerns remain as to the timely detection of errors or irregularities.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2006
(Continued)

In April 2006, PERF revised the policies and procedures in place concerning transferring contributions into investment accounts. In June 2006, PERF adopted investment accounting and reconciliation procedures which include provisions for timely performance and communication of results. Based upon our review of the procedures in place and interviews with staff, the concern remaining is that there is an insufficient process to detect an irregularity should it occur as an insufficient segregation of duties exists with respect to investment accounting. The same staff person is responsible to solely authorize bank withdrawals, communicate the withdrawals, record the general ledger entry for the withdrawals and the investment income, and verify the entries and bank spreadsheet summaries to the bank statements. An investment analyst verifies that the bank records the order as transmitted by accounting, but does not review to ensure that all transfers recorded by the bank have been properly authorized. Another accountant also reviews the general ledger entries for investment income, but utilizes spreadsheets provided by the accountant who has multiple duties, and does not also review the other investment transaction entries.

Indiana Code 5-10.3-3-7.1 states: "The board shall annually analyze for internal control purposes the fund's: (1) income and expenditures; (2) actuarial condition; (3) reserve accounts; (4) investments; and (5) such other data as necessary to interpret the fund's condition and the board's administration of the fund."

We recommended that PERF improve investment controls by either requiring two signatures to authorize withdrawals or assigning another accountant the duties of reconciling the investment bank statements to the general ledger entries. Also, the investment analyst should review the bank records to ensure that all transactions were properly authorized.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
EXIT CONFERENCE

The contents of this report were discussed on October 26, 2006, with David Adams, Executive Director; Terren Magid, Chief Operating Officer; and Ken Cochran, Chairman of the Board. The official response has been made a part of this report and may be found on pages 15 and 16.



OFFICIAL RESPONSE

143 WEST MARKET STREET

INDIANAPOLIS, IN 46204

LOCAL 317.233.4162

TOLL FREE 888.526.1687

WWW.PERF.IN.GOV.

State Board of Accounts
Indiana State Board of Accounts
302 West Washington Street
Room E418
Indianapolis, Indiana 46204

Ladies and Gentlemen:

This letter serves as our response to the State Board of Accounts Audit Results and Comments for the Public Employees Retirement Fund (PERF) dated June 30, 2006. The results of this audit were presented to PERF on October 26, 2006. The PERF management team appreciates the comments and insights provided by the State Board of Accounts.

The PERF leadership team is extremely proud to receive an unqualified opinion for the fiscal year. Management recognizes that this is the first clean financial opinion in four years. This is the result of a tremendous effort by PERF to improve the internal controls and procedures at PERF. As stated in my previous letters to the State Board of Accounts, many of the issues identified were longstanding problems. We believe this unqualified opinion represents PERF's time and resource commitment to accurately and completely represent the financial condition of this organization. Due to prudent and sound management, financial integrity is restored to this great institution. The members and employers of PERF should gain significant confidence in PERF's ability to properly manage the funds.

We are encouraged by the reduction in audit findings. Management recognizes that many of the solutions to the remaining findings were implemented but will need to be further audited during the next audit period. The leadership team continues to be committed to implement the necessary changes to improve PERF's operations.

PERF leadership is equally encouraged by the improved audit process and the dramatic reduction in the timeframe to complete the audit. This represents an improvement of two months over the last audit and six months from my first exit conference on April 20, 2005.

Public Employees' Retirement Fund

Legislators' Retirement System

1977 Police Officers' and Firefighters' Pension and Disability Fund

Excise Police and Conservation Enforcement Officers' Retirement Plan

Prosecuting Attorneys' Retirement Fund

1977 and 1985 Judges' Retirement System



In addition to the clean financial opinion, PERF continues to be a strong retirement system and leadership has implemented many significant changes that have improved customer service. As a retirement system, PERF increased its assets approximately \$1.3B during the fiscal year and grew to the 90th largest retirement system in the United States. Benefit improvements resulted in a nearly 80% reduction in time to complete a refund as well as a 44% reduction in the amount time to receive a retirees first check. It is worth noting that 91% of the retirements processed in September 2006 occurred with no payment interruption. These accomplishments occurred at a time when the workload had significantly increased as well. The PERF Interactive website was launched and nearly 15,000 subscribers have joined. Web traffic to the completely redesigned website was up over 90% during the fiscal year. PERF personnel were recognized at both of the 2006 Governor's public service award out of the more than 30,000 employees.

These are just some of the many highlights that occurred at PERF during the last year.

Again, I want to thank the State Board of Accounts for their insight and assistance. As always, PERF looks forward to continue working with the State Board of Accounts to improve operations.

Sincerely,

David J Adams
Executive Director